

Depressed commodity prices point to slower Thai growth, wider trade gap.

Indonesian officials hard pressed on policy owing to dismal export forecast.

Increased foreign aid likely to relieve Ethiopian trade deficit.

Zambian economic upturn awaits copper-market turnaround.

Thailand enjoyed robust real economic growth of 7.8% in 1981, up substantially from 1980's 5.8%. Agricultural production increased a record 5.3%, thanks to good weather. And industrial growth rose to 8.4% from 6.2% a year earlier, despite the world recession and its effects on exports. Consumer-price inflation decelerated to about 12.8% from 19.7% in 1980 as money growth slowed. Agricultural exports were up strongly in volume terms but much less in value because the prices for Thailand's major commodity exports declined sharply. As a result, the trade deficit increased to close to \$3 billion from \$2.8 billion in the previous year. In 1982, real growth is projected to slow to 6% as farm incomes decline and agricultural output responds to the depressed prices. Inflation is expected to moderate further to 10%. Despite increased use of domestic gas, the trade gap is expected to widen to perhaps \$4 billion, as the prices of Thailand's major commodity exports remain low.

A poor export outlook is forcing some tough policy decisions on the Indonesian government. Oil and gas revenues were essentially flat in 1981, and non-oil exports declined by 25% in nominal terms. Imports, on the other hand, continued to increase and the current account recorded its first deficit in several years—about \$1 billion according to preliminary estimates. Continued weakness in the oil and commodity price outlook for 1982 suggests the current account will deteriorate further this year. With development expenditures on the rise, the government has been pressed to make some bold and politically surprising changes in fiscal and trade policies in order to offset the stagnating oil revenues. Despite large increases in domestic prices, authorities cut fuel and food subsidies by 39% in the fiscal 1982-83 budget. In addition, the government has initiated a series of export promotion measures, restricted imports of certain consumer products, and instituted a controversial "counter-purchase" scheme, whereby some of the foreign companies awarded government contracts are required to arrange for the export of Indonesian products equal to the value of materials and equipment brought into the country.

Ethiopia, continues to suffer from severe foreign-exchange constraint owing largely to persistent price weakness of its major export commodity, coffee. According to preliminary reports, the fiscal 1980-81 trade deficit widened some 40% to \$331 million, despite import restrictions. Technical assistance and other grants contained the current-account shortfall at \$204 million, up from \$126 million in the previous year. And a near-doubling of capital inflow held the overall balance-of-payments deficit to \$59 million, which was financed by international reserve draw-down, IMF credit, and gold sales. Although both a modest improvement in export receipts—mostly the result of volume increases—and continued import restraint are expected in fiscal 1981-82, projections show only a marginal narrowing of the current-account deficit. On capital account, geo-political considerations and the country's reputation for prudent economic management are likely to produce increasing aid inflows from western nations, which could result in a somewhat lower deficit on the overall balance of payments.

Price weakness and reduced world demand for copper and cobalt led to an estimated 10% widening of Zambia's current-account deficit in 1981 to \$555 million. Lower output of the minerals—which together account for about 95% of Zambia's export receipts—caused real GDP to contract by 1.8%. Moreover, mining company operation losses erased contributions to government revenue, giving rise to a budget deficit of \$370 million. While no upturn is expected for cobalt this year, there is a chance that the copper market will strengthen toward year-end. The economy should also benefit from the impending merger of the two major state-controlled mining companies and their planned capacity expansion. Thus, while the balance of payments position remains grave over the near term and the government braces itself for a 56% higher budget deficit, there is cause for guarded optimism for the economy in 1983.

Economic Assumptions Critical to Budget Policy

The recent release of President Reagan's proposed budget for fiscal 1983 raises renewed questions concerning the effectiveness of his economic program. During the presidential campaign and throughout 1981, Reagan's advisers contended that tax reductions—chiefly reductions in personal income tax rates for individuals and accelerated depreciation for businesses—would spur economic growth sufficiently to move the budget toward balance. Cuts in non-defense spending would be large enough to accommodate sharply higher defense spending while still preserving the goal of a balanced budget in fiscal 1984. At the same time, the Federal Reserve was to steadily lower the rate of growth of the money supply so as to reduce inflation.

In the new budget proposal, however, the administration has calculated deficits for fiscal years 1982 and 1983 of \$95.6 billion and \$91.5 billion, respectively. Thus, market fears that large deficits would not soon disappear seem to be confirmed. Indeed, the administration acknowledges in the budget document the specter extremely large deficits can raise: "Due to the economic influences . . . and incomplete action on the administration's program last year, the budget deficit would soar into the triple digit range and remain there beyond 1987 without corrective action. Deficits of this magnitude would impose extreme pressures on financial markets, [and] undermine the outlook for con-

tinued monetary restraint, reduced inflation and economic growth. . . ."

The Reagan Administration's March 1981 budget proposal had estimated budget deficits of \$41.7 billion in fiscal year 1982 and only \$2.4 billion in fiscal 1983. This projection was based upon assumptions of economic growth of 5.2% and 4.9% in 1982 and 1983, respectively, along with 91-day Treasury bill rates of 8.9% and 7.8%, and increases in the CNP price deflator of 7.7% and 6.6%. The deficit numbers also assumed that Congress would pass the tax and spending reductions as proposed.

In explaining why the deficit projections are now so much larger, President Reagan blamed "recession, higher interest rates, declining inflation, and incomplete congressional action." The economic growth and interest-rate assumptions in the current budget plan are certainly much more pessimistic than those of last March: economic growth of 3.0% in 1982 and 5.2% in 1983, and interest rates to average 11.7% and 10.5%. (Inflation, however, is now expected to fall to 7.2% and 5.5%.) And Congress did fail to enact all the spending cuts Mr. Reagan had requested. Moreover, on its own initiative, Congress added many items to the tax bill—such as the "All-Savers" Certificate and the transfer of investment tax credits through leasing—that enlarged the Treasury's near-term revenue loss.

Asia and Oceania Bimonthly Survey of Business and Finance

	COUNTRIES	CURRENT BUSINESS CONDITIONS	EXPORTS		GNP IN 1980		BALANCE OF PAYMENTS			
			6 months ending	12-month change	in billions of dollars	per capita	latest data	reserves (less gold) in million \$	12-month change	months of imports covered
Asia	Bangladesh	Import restrictions depress industrial production; food crops hurt by drought and pests.	Aug.	— 4%	12.5*	\$ 134	Dec.	138	— 54%	0.6
	Burma	Inflation close to zero in 1981, although price rise may be accelerating.	Oct.	+ 5%	5.6*	174	Dec.	212	— 19%	7.6
	China, People's Republic	Austerity budgets continue as recovery begins in heavy industry.	Sept.	+ 17%	242.2	246	Sept.	3,936	— 6%	2.2
	Hong Kong	Strong domestic demand supports real economy; government estimates 10% growth for 1981.	July	+ 23%	21.5	4,290	n. a.	—	—	—
	India	Economic program stresses liberalization of investment procedures, better public-sector performance.	June	— 2%	172.6*	257	Sept.	5,009	— 34%	4.0
	Indonesia	Government reduces oil and food subsidies to finance expanded development program.	Mar.	+ 9%	66.3	437	Dec.	5,014	— 7%	5.4
	Japan	Domestic demand remains in doldrums and exports are slowing.	Nov.	+ 13%	1,044.0	8,940	Dec.	28,208	+ 14%	2.5
	Korea	New cabinet announced measures designed to bolster business confidence.	Nov.	+ 21%	57.8	1,513	Dec.	2,679	— 8%	1.3
	Malaysia	Domestic activity continues to be dampened by poor export performance.	Aug.	— 15%	22.8	1,697	Oct.	3,705	— 21%	3.9
	Pakistan	Unfavorable rains raise concern about wheat crop.	Sept.	+ 21%	27.8*	337	Dec.	721	+ 45%	1.6
	Philippines	Depressed condition likely to persist because of continued slow growth in industrial countries.	Aug.	0	35.1	726	Nov.	2,244	— 15%	3.1
	Singapore	Real growth for 1981 estimated at 9.7%, thanks to vigorous service industry.	Oct.	+ 5%	10.5	4,390	Sept.	6,828	+ 6%	3.0
	Sri Lanka	Capital expenditure to surge 40% in 1982 as work on Mahaweli Project accelerates.	Aug.	— 4%	4.1	277	Dec.	327	+ 33%	2.0
	Taiwan	New Four-Year Plan (1982-85) aims at 8% average growth.	July	+ 15%	40.2	2,278	Aug.	4,468	+ 161%	2.3
	Thailand	Lower export prices, particularly for rice, depress farm incomes.	Sept.	+ 21%	32.2	693	Dec.	1,732	+ 11%	2.1
Oceania	Australia	Government tightens foreign investment rules governing rural land, promotes auto competitiveness.	Dec.	— 5%	137.4	9,401	Dec.	1,671	— 1%	0.7
	Fiji	Development plan for 1981-85 aims at 4.7% average growth, emphasizing infrastructure development.	Sept.	+ 8%	1.0**	1,628	Dec.	135	— 19%	2.9
	New Zealand	Government pledges continuation of resource development strategy after narrow election win.	Oct.	+ 3%	21.2*	6,714	Dec.	666	+ 89%	0.7

*Fiscal year

**1979

The new budget proposal attempts to address the problem of ever-increasing deficits through a variety of means. Further reductions in the volume of non-defense expenditures are planned; user fees for certain federal facilities would rise; management initiatives (better tax and debt collection, for example) would be undertaken; and tax "revisions" (read: increases) will be proposed. If all of the proposals requiring legislative action were passed, and if the economy were to perform as well as the Administration projects, the deficit in the so-called "out-years" (beyond 1983) would steadily decline to \$53.2 billion in 1987.

But even this improving outlook for the deficit still depends crucially upon the economic assumptions. One percentage point lower economic growth increases the deficit by about \$10 billion, while interest rates one percentage point higher add about \$4 billion. Lower assumed inflation actually adds to the deficit because revenues would drop more than outlays: about \$3 billion for each one percentage point.

Real economic growth prospects for the next two years do not seem as sanguine as the Administration's projections. Chase's own projections show considerably slower real growth in 1982 and 1983 than what the Administration is assuming, with the economy skirting another recession in 1983 as restrictive and, more importantly, uncertain money policy places limits on nominal growth. The inflation forecast very nearly matches the Administration's expectations—both are strongly based on the assumption that the Federal Reserve will maintain monetary growth within its

1982 target ranges, on average—while the interest rate forecasts are also quite similar.

The tax incentives to boost investment through increased saving will be unlikely to have a major impact as early as this year. With capacity utilization about 70%, there is little incentive for expansion plans. And with real costs of financing many percentage points above the rate of inflation, most firms may find it more profitable to restructure their balance sheets—by paying down debt or increasing liquid assets—with their increased cash flow from accelerated depreciation than even to modernize existing operations. So, the sector that is to be the engine of growth may be a little slow in leaving the station.

If this worse economic performance were to occur, the fiscal 1982 deficit could be about \$15 billion higher, and the fiscal 1983 gap could grow by even more. Despite the prospect of continuing deficits exceeding \$100 billion, however, the Reagan Administration could still be judged a success by its favorite yardstick—slowing the growth rate of federal expenditures sufficiently so as to reduce the share of GNP claimed by the government. Ultimately, it is the level of expenditures, not taxes, that is most important to the economy. Whether the government finances its expenditures currently by taxation, or shifts the liability into the future by borrowing, an equal amount of resources would be transferred. It is this task of reducing the resource transfer that the 1983 budget puts squarely into the hands of Congress.

Douglas L. Bendt

ICE OF PAYMENTS		MONEY AND BANKING							COUNTRIES
use of IMF credit, mil- lions of dollars	current influences on payments	12-month changes				exchange rate		current monetary conditions	
		latest data	consumer prices	latest data	money supply (M1)	in U.S. dollars	change from year earlier		
							February 9, 1982		
32	Import restrictions start to slow import payments.	Sept.	+12%	Sept.	+20%	.0518	-20%	Credit conditions continue re- strictive.	Bangladesh
57	Exports up 22% in first nine months of 1981.	Oct.	+4%	Apr.	+13%	.1348	-6%	Pegging of kyat to SDR main- tained.	Burma
531	Imports rising after demand restrictions last year.	Dec.	+8%	Sept.	+23%	.5590	-10%	Money supply stable or declin- ing at end-1981.	China, People's Republic
—	Growth in both exports and imports slows.	July	+15%	July	+3%	.1709	-10%	Interest-rate ceilings on short- term deposits to be lifted.	Hong Kong
689	Cutback in IDA funds will force borrow- ing on less concessional terms.	Oct.	+13%	July	0	.1105	-10%	Credit continues restrictive under IMF program.	India
0	Foreign investors required to export Indone- sian goods to get import licenses.	Oct.	+10%	Aug.	+27%	.0016	0	Rupiah weakens slightly, re- sponding to payments deficit.	Indonesia
0	Government reduces non-tariff trade bar- riers in attempt to ease trade friction.	Dec.	+4%	Oct.	+8%	.00424	-14%	Ceilings on bank lending lifted for the first quarter.	Japan
1,246	Government marks down won, aiming to improve export competitiveness.	Nov.	+16%	Nov.	0	.0015	-2%	Direct control on bank credit lifted.	Korea
22	Japanese-style trading company formed to help expand export markets.	Sept.	+11%	Sept.	+9%	.4425	-1%	Loss of reserves moderating do- mestic money growth.	Malaysia
757	Ruppee delinked from strong dollar in re- sponse to sluggish exports.	Oct.	+13%	Oct.	+9%	.1000	-2%	Credit conditions continue re- strictive under IMF guidance.	Pakistan
998	Oil imports could slow if large stocks are run down.	Oct.	+11%	Oct.	+10%	.1218	-10%	Easing of reserve requirements will boost liquidity.	Philippines
0	Government Investment Corporation plans to invest surplus funds abroad.	Sept.	+10%	Sept.	+7%	.4761	-1%	Interest rates decline further.	Singapore
408	Current-account deficit was \$430 million in 1981, vs. \$660 million in 1980.	Oct.	+18%	Sept.	+16%	.0500	-12%	Last drawing made under IMF Extended Fund Facility.	Sri Lanka
0	Trade surplus estimated at \$1.4 billion for 1981.	Aug.	+17%	Aug.	+8%	.0286	-1%	Interest rates lowered further.	Taiwan
708	Continuation of commodity-price recession widens trade gap.	Oct.	+12%	June	+8%	.0455	-10%	Foreign-loan tax holiday re- newed.	Thailand
0	A\$ allowed to slip against currency basket owing to overall payments deficit.	June	+9%	Oct.	+7%	1.1000	-6%	Money supply growth on govern- ment target path.	Australia
0	Weak commodity prices cause widening current-account deficit.	Dec.	+10%	Nov.	+9%	1.1160	-11%	IMF grants \$15 million to com- pensate for export shortfall.	Fiji
39	Meat exports at record level in 1981.	June	+15%	Oct.	+3%	.7940	-16%	Money supply and credit growth continue high.	New Zealand

World Interest Rates

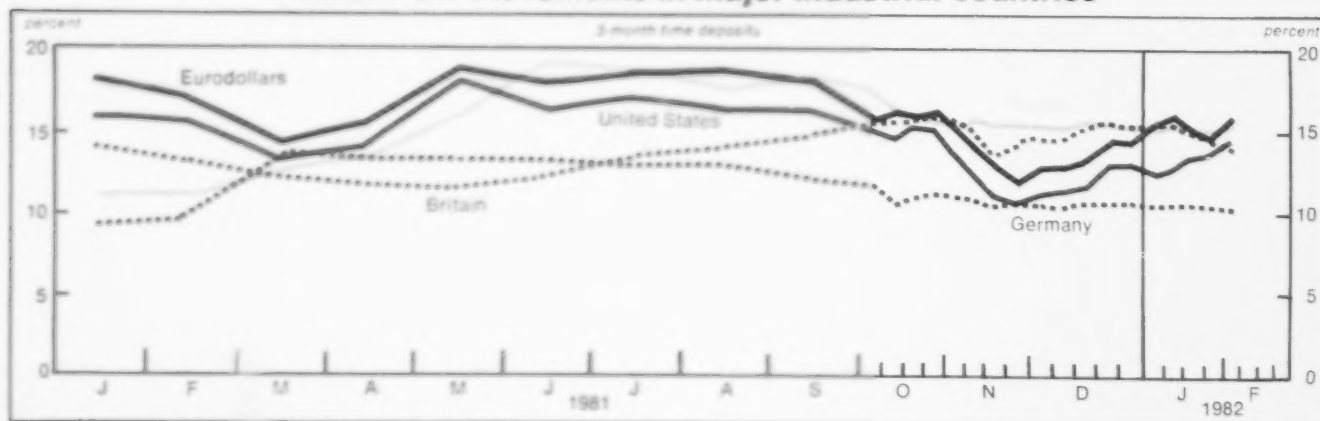
market rates of Feb. 9, 1982; bond yields as of Feb. 5, 1982

in percent per annum	U.S.	Canada	Britain	Belgium	France	Germany	Italy	Netherlands	Switzerland	Japan
Central Bank Discount Rate	12.00	14.74	13.791 intervention rate	14.00	9.50	7.50	19.00 penalty rate 22.00	8.50	6.00	5.50
Day-to-Day Money	15.24 February 10	15.00	14.375	12.25	14.75	10.00	20.375	10.25	2.75	6.75
Treasury Bills 91-day, Middle Rates	14.14 discount basis	14.70	13.50	15.15	n. a.	n. a.	18.899 90-days	no dealing	no market	5.625 two-month
Commercial Paper prime, 3-month, asked	14.75 finance paper discount basis	15.45 finance paper 15% tax w/h	12.95	13.90 Certified	15.00 interbank	no market	no market	no market	no market	not traded
Bankers' Acceptances 3-month, asked	14.90	15.40 15% tax w/h	13.812	13.90 Certified	not traded	9.90	23.20	no market	8.3125	no market
Government Bonds Long-term, new and old issues, average yield	14.74	16.125	14.48	11.065 20% tax w/h	15.91	9.79	20.85	11.10	5.48	7.671
Industrial Bonds prime, long-term, new and old issues, average yield	15.70 As Industrials	17.00	15.94	15.808	17.12	9.85	20.41	12.13	6.40	7.15
Bank Short-Term Rate to Best Borrowers (prime rate)	16.50	16.50	15.00	18.00	16.85	14.00	22.50 1/4 yearly fee on outstg.	12.00	9.50	6.00
Bank Time Deposits 3-month	15.125 Cert. of Dep.	15.50	14.562	15.00	15.00	10.00	10.75	10.25 large deposits	8.00 residents only	3.75 20% tax w/h
Eurocurrencies 3-month, asked	16.1875	no market	14.75	no market	15.75	10.25	no market	10.1875	8.3125	no market
Exchange Rates—in U.S.\$ rates floating against the \$	—	.8227	1.8490	.0248	.1662	.4223	.000789	.3841	.5241	.00424
Forward Exchange Cover 3-month, in percent p.a. D = discount, P = premium	—	.5265 P	1.622 P	2.479 D	.4987 P	5.065 P	6.319 D	5.532 P	7.547 P	9.497 P

Eurodollar Deposits (London, interbank, bid) February 10 7-day 15.50 1-month 15.9375 3-month 16.1875 6-month 16.1875	International Arbitrage (3-month, hedged) ↗ in favor of U.S. dollars U.S.-U.K. Treasury Bills — .796 U.S.-Canada Treasury Bills — .386 U.S.-Canada Finance Co. Paper — 1.015 Eurodollars-U.K. Local Auth. Deposits — .1845	Eurobonds (average yield on recent straight debt issues) U.S. Dollar Bonds 7 yrs. and under 15.875 Over 7 yrs. 16.125 DM Bonds 7 yrs. and under 9.81 Over 7 yrs. 9.75	Gold Price London afternoon fixing 378.50 (per fine ounce)
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The above interest rate quotations refer to the past week and may not be construed as offers by The Chase Manhattan Bank. The quotations for Bank Short-Term Rate to Best Customers, while including customary commissions, reflect neither possible other fees nor varying compensating balance requirements.

Interest rate movements in major industrial countries



Spain: Slow Progress on the Road to Recovery

Spain's protracted economic slump may at last have bottomed out. Unexpected strength in exports and tourism has generated cautious optimism that a modest recovery may have begun in the second half of 1981. At this point, however, the turnaround is tenuous, at best. There is much about the Spanish economy that remains troublesome: Weak domestic demand persists despite prospects of another expansionary government budget; unemployment has continued its relentless upward climb and is projected to worsen throughout this year and into 1983; and private domestic investment remains depressed in the face of sluggish demand and political uncertainty. There are subtle signs that Spain has made progress in the slow process of structural adjustment, which over the longer term will help to correct these problems and bring the economy back to health. But with the external sector left as the principal source of economic salvation in the short run, the scope for a strong and early revival is limited.

In its post-Franco era, Spain has had to grapple not only with two oil price hikes, but also with the gradual opening up and liberalization of the economy during a period of political transition. The result has been a fundamental change in economic performance. Since 1975, economic growth has fallen below the OECD average. Unemployment has soared as companies once protected under the isolationist policies of the old regime have been forced to shed surplus labor in order to remain competitive. A broad-based rise in almost all forms of public expenditures has pushed the government budget from surplus into a large and growing deficit. But despite burgeoning public consumption, overall domestic demand has recently weakened. Rising unemployment has curtailed private spending, while at the same time, political uncertainty and a squeeze on profits have inhibited private investment—except for a few large projects by multinational corporations. The balance of payments began to worsen in mid 1979, following a rise in the price of oil and the institution of government policies designed to stimulate imports. The external sector then became a net contractive force in 1980 when exports were adversely affected by exchange-rate movements.

In essence, the Spanish economic experience in 1981 was a continuation of the same dismal trends. Economic growth languished at less than 1% in real terms, as the number of unemployed Spaniards rose to 1.74 million, or 14% of the labor force, in spite of the government's increased deficit spending. Government officials made little attempt to contain the deficit. A strong peseta early in the year aggravated exports and tourism, resulting in a current-account deficit estimated at \$5.5 billion, up from \$4.6 billion in 1980.

A few positive signals however, could also be deciphered from last year's gloom. Although weak, the economy did manage to sustain positive growth despite a severe drought that cut Spain's agricultural harvest by some 6%. This was an achievement matched by few OECD nations. Real wages actually began to fall in the face of the high and rising unemployment. And with private credit demands weak, the Bank of Spain was able to maintain monetary policy tightly enough to achieve a marginal improvement in the rate of inflation: down to 14.4% in 1981 from 15.6% in 1980 and 15.7% in 1979. In addition, perceptible progress was made in addressing some of the structural problems of the economy. After lengthy delays, consumer energy prices were raised substantially and implementation of National Energy Plan investments was begun. Furthermore, additional steps were taken in the liberalization of both the financial system and the labor markets. These signs bode well for Spain's eventual return to a healthier economy over the long run, even if they have only marginal significance for the immediate outlook.

Near-term prospects

The capacity for a robust recovery in 1982 is severely limited. Although the Spanish government has forecast real growth of 3%, private forecasters are not nearly so optimistic. Domestic activity is far from buoyant despite yet another expansionary budget. There is little to bolster consumer demand, as unemployment is expected to continue rising throughout the year before stabilizing sometime in 1983, and real wages are anticipated to decline further. Similarly, private investment demand will probably remain depressed in the face of inadequate orders, high interest rates, and political uncertainty.

The external sector is the most likely source of recovery, and even here prospects are not especially good. Europe, Spain's major export market, is moving out of recession only very slowly. And demand for big-ticket Spanish exports, such as motor cars, is anticipated to be especially weak during 1982. In addition, Spanish exporters have been experiencing declining competitiveness over the last year as the peseta has remained generally in line with European currencies while Spanish costs have risen more rapidly. Nevertheless, the export rally in the latter part of last year augurs well for Spanish exports. And with import demand weak, the external sector is expected to be a net contributor to economic growth in 1982. Overall, real GDP growth is projected to be a modest 1.5%—somewhat stronger than last year. However, the effects of last year's drought could exert some residual drag on the economy.

Spain: Slow Progress on the Road to Recovery *(continued from page 7)*

With so fragile a recovery in process, Spain's ever expanding fiscal deficit is generating increasing concern. According to the official 1982 budget plan, the deficit will rise to pta. 700 billion from a budgeted pta. 400 billion in 1981. However, in view of the government's past record for overshooting its projections (the *actual* 1981 deficit was an estimated pta. 700 billion, 4% of GDP), the actual deficit will almost certainly reach pta. 1 trillion or 5% of GDP. Compared with other countries, Spain's deficit absorbs a relatively small portion of its national product. Furthermore, most of the fears about the deficit have centered more on its growth than on its level. For 1982, however, there is some concern that because the huge fiscal gap will largely be financed domestically, there could be some crowding out of private sector investment expenditures. Given expectations of what the Bank of Spain's stance on monetary policy is likely to be, funding the large deficit will add to other pressures on interest rates.

On the positive side, the forecast points to a small improvement in Spain's balance of payments in 1982—the first since 1978—although an overvalued peseta could be a detrimental force. The current-account deficit is projected to decline to \$4.5 billion, with much of the improvement coming from services receipts, particularly tourism. The 1982 World Cup Soccer Tournament will be played throughout Spain this summer and should attract large numbers of tourists from Europe and South America.

Another positive development in 1982 is likely to be some additional easing of inflationary pressures. It is anticipated that the Bank of Spain will continue its gradual reduction of monetary growth. This action will be aided from the cost side by further moderation in real wages and by softening world oil prices. The average annual rate of consumer price inflation is expected to drop to 13.5% as a result, although food prices will come under some pressure because of the drought.

Unresolved issues

Despite advances in the structural transformation of the Spanish economy, the road to revival is still likely to be slow and full of potential pitfalls. The country's dearth of domestic energy resources, for example, leaves the economy still susceptible to sudden rises in the price of imported oil.

In addition, in spite of the many new and highly

efficient investments made in a relatively liberalized economic environment, the country remains saddled with an old, inefficient industrial base. And with Spain's persistently depressed investment performance, this will continue to be a drag on the economy. Gross fixed capital formation is one of the lowest in the OECD. Moreover, a significant proportion of the new investments are not in direct capacity generating projects.

The implications of Spanish entry into the European Economic Community (EEC) are of great importance to the economy. It is now certain that the original deadline of a 1983 entry is not feasible as, because of internal disagreements in the EEC, negotiations have yet to begin. The long-term reality of this move for Spain will be whether the benefits of expanded export markets will exceed the cost of losing domestic markets to EEC imports. The current level of inefficiency in Spain's domestic industries offers the opportunity for substantial import penetration by EEC producers. Spain's hope is that negotiations with the EEC will result in a period of transition long enough to correct some of these inefficiencies. On balance, membership in the EEC is expected to be beneficial to the Spanish economy, although the initial years could be difficult.

Unemployment has become the most politically important economic issue in Spain—and one that is not likely to be resolved soon. The underlying cause has been a necessary shedding of excess labor by industries previously over-manned because of restrictive labor legislation. Many companies are still carrying surplus labor that will need to be released. Thus, unemployment is not expected to peak until sometime in 1983, when the number of jobless may rise as high as 2 million. As a result, socio-political pressures could result in further expansionary fiscal and monetary policies, which would aggravate inflation and probably worsen Spain's balance-of-payments position.

Despite all of Spain's problems and vulnerabilities, there is some room for optimism in the outlook beyond 1982. Productivity growth has been high in recent years, averaging 4.3% over 1975-80—a level only slightly lower than that for Japan. And a number of new investments in Spanish industry have shown themselves to be highly competitive in international markets. Although Spain's short-term prospects are only modest, there is now some evidence that the country has begun to adjust to changing economic conditions.

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